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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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SEP 23 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of the Cable Act of 1992	)	MM Docket Nos. 92-264, 92-265, 92-266
	)	

Rate Regulation
Horizontal and Vertical Ownership Limits
Development of Competition and Diversity
of Video Programming Distribution and Carriage

To: Cable Services Bureau

PETITION TO UPDATE CABLE TELEVISION REGULATIONS AND FREEZE EXISTING CABLE TELEVISION RATES

Consumers Union (CU)[1] and Consumer Federation of America (CFA)[2] hereby submit this petition, pursuant to 47 C.F.R.§§1.41 and 1.401,[3] requesting that the Federal Communications

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1 Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 4.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

2 The Consumer Federation of America is a non-profit association of 240 pro-consumer groups, with a combined membership of 50 million, founded in 1968 to advance the consumer interest through advocacy and education.

3 We are filing this petition, which asks the Commission to reassess some of its cable rate regulations and make necessary revisions, under the general rules of the FCC that

Commission ("FCC" or "Commission") immediately freeze rates for basic and cable programming services for cable systems subject to regulation while it reevaluates certain cable television regulations. We ask the FCC: 1) to freeze rates and develop rate regulations that ensure reasonable rates; 2) to lift its stay of its regulations that establish horizontal ownership limits; and 3) to reevaluate its current horizontal and vertical ownership limitations and rules prohibiting unfair practices, in light of recent mergers, acquisitions and other developments in the cable industry that have significantly increased concentration and undercut competition in the cable television marketplace .

INTRODUCTION AND SUMMARY

The Cable Television Consumer Protection and Competition Act of 1992 (1992 Cable Act)[4] was enacted five years ago to stem the tide of rising cable rates. During the period prior to enactment of the 1992 Cable Act, cable rates were increasing at a rapid pace.[5] From 1986-1992, the U.S. Bureau of Labor Statistics (BLS) reports that rates for cable service had increased by

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govern petitions for rulemaking and informal requests for Commission action. Whether this petition is considered a petition for rulemaking or an informal request for Commission action, it is clearly not a complaint regarding specific cable rates and, therefore, is in no way governed by section 623(c)(3) of the Communications Act, which limits the time period during which a complaint can be filed about cable programming rates, or by an amendment to this section made in Sec. 301 of the Telecommunications Act of 1996, which allows only local franchising authorities, and not single subscribers, to file rate complaints with the FCC.

4 Pub. L. No. 102-385, 106 Stat. 1460 (1992).

5 The Government Accounting Office found that, from December 1, 1986, through October 1988, monthly rates for the lowest priced basic service increased by 29% percent, while monthly rates for the most popular basic cable service increased by 26%. S. Rep. No. 92, 102nd Cong., 1st Sess. 5 (1991) *reprinted in* 1992 U.S.C.C.A.N. 1133, 1137.

almost 60 percent nationwide.[6] Moreover, since cable rates were deregulated in 1986, the average monthly cable rate had increased almost three times as much as the Consumer Price Index (CPI).[7]

In enacting the 1992 Cable Act, Congress's intent was to "promote competition . . . and to provide protection for consumers against monopoly rates . . . ." The law gives the FCC authority to adopt regulations "aimed at curbing the cable operators' and programmers' market power."[8] Under the 1992 Act, the FCC developed rules designed to prevent cable companies from discriminating against unaffiliated video distributors and programmers, and established ownership limits designed to prevent further monopolization of the cable industry.[9]

Despite some initial savings to consumers, the Commission's implementation of the law has failed to restrain monopolistic pricing or anticompetitive practices by the cable industry. In short, the Commission's implementation efforts are not furthering Congress' goal of reasonable prices and broad-based competition. At best, market forces are weak in the cable industry and

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6 Statement of Dr. Mark Cooper attached as part of this petition, Table 1.

7 H.R. Conf. Rep. 862, 102nd Cong., 2nd Sess. 55 (1992) *reprinted in* 1992 U.S.C.C.A.N. 1231, 1237.

8 S. Rep. No. 92, at 102nd Cong., 1st Sess. 1 (1991) *reprinted in* 1992 U.S.C.C.A.N. 1133, 1137.

9 The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, included a number of cable reform provisions. Primarily, it made several changes in rate regulation: it amended the definition of "effective competition" to include the provision of video programming by a local exchange company or its affiliate (47 U.S.C. §521 et seq.; it deregulated small cable companies' upper tiers of service (47 U.S.C. §543(m)); and sunsetted all regulation of rates for cable programming service on March 31, 1999 (47 U.S.C. §543(c)(4)). None of these provisions, nor any other provisions of the 1996 Act, have any effect on the issues addressed in this petition.

becoming weaker.[10] The situation today is as bad as -- if not worse than -- it was in 1992. From the consumer point of view, the most visible and immediate indication of the deteriorating conditions in the industry is the price which consumers must pay for services.[11] Cable rates increased more than three times as fast as inflation since Congress passed the Telecommunications Act of 1996 in February 1996,[12] faster than when cable was not regulated. Rates are rising 50% faster than the Commission claimed its rules would permit.[13] Steadily increasing cable rates, coupled with greater consolidation and anticompetitive behavior among cable operators, demand prompt action by the Commission.

In the past year, a dangerous acceleration in questionable cable industry behavior has occurred, which has resulted in sharply increased market power, anticompetitive actions, and unprecedented price increases. These developments make it incumbent upon the FCC to take action to reverse these trends.[14] We urge the FCC to freeze existing cable rates while it investigates the causes for the rapid increases in cable rates and determines what changes must be made to its cable rate regulation formula. In addition, the Commission should reevaluate and improve the effectiveness of its rules limiting vertical integration of cable operators and

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[10] Cooper Statement at ¶2.

[11] *Id.* at ¶6.

[12] The BLS reports that the cable consumer price index has risen 11.7% since February 1996, while the general Consumer Price Index (CPI) rose 3.6%.

[13] Cooper Statement at ¶12.

[14] Cooper Statement at ¶17.

prohibiting anticompetitive behavior. Finally, the FCC should lift its self-imposed stay of the horizontal ownership restrictions and tighten these concentration limits.

I. THE COMMUNICATIONS ACT PROVIDES THE FCC WITH THE AUTHORITY TO FREEZE CABLE RATES WHILE IT INVESTIGATES ITS RATE REGULATION FORMULA.

A. Section 623 of the Communications Act provides the Commission with authority to freeze cable rates and investigate the existing formula for regulation of cable rates.

Section 623(b)(1) of the Communications Act, 47 U.S.C. §543(b)(1), directs the Commission to "ensure that the rates for the basic service tier are reasonable." This provision gives the Commission "broad discretion" to ensure reasonable rates.[15] In addition, Section 623(c) of the Act, 47 U.S.C. §543(c) provides the Commission with the authority to establish rates for cable programming services if it finds that existing rates are unreasonable.

The FCC relied on section 623(b)(1) in April 1993 when it froze cable rates for 120 days while it finalized its cable rate regulations.[16] The Commission concluded that only by freezing the rates could it ensure that cable rates would remain reasonable until final regulations became effective.[17]

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15 S.Rep. No. 92 at 73.

16 *See Order*, in MM Docket 92-266, Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, 8 FCC Rcd 2921 (1993) ("*Cable Rate Freeze Order*"). The freeze applied only to rates for other than premium and pay-per-view service offerings, and only to those cable systems subject to FCC regulatory authority (those systems not subject to effective competition).

17 *Id.* at 2922.

Just as the Commission relied on section 623(b)(1) to institute a cable rate freeze in 1993, it can now use this same provision, along with section 623(c), to support a freeze of current cable rates while it undertakes a reevaluation of its cable rate regulations. The 1993 rate freeze was instituted at a time when cable rates had been steadily increasing. The FCC determined that it was imperative to hold rates at a set level while it was finalizing regulations that would provide clear limits on cable operators' abilities to raise rates. Without a freeze, the temptation was too great for cable companies to slip in one or two more rate hikes before the final rules went into effect.

Similar circumstances exist today, and a similar response is necessary. In the period since the FCC relaxed cable regulation and finalized its "Going Forward Rules," cable rates have also been rising at a rate that almost equals the rapid rate increases of the late 1980s. Since adoption of the Going Forward Rules in 1994, prices have increased by 6.3% per year.[18] Considering only the time since passage of the 1996 Act, prices have been increasing by about 8.2% per year.[19] Prices are, overall, 4% higher than was expected by the Commission when it published the Going Forward Rules. Since passage of the 1996 Act, prices have increased almost 50% faster than the FCC predicted.[20] In other words, prices are going up faster than ever before, and at a rate that far exceeds what the Commission claimed would occur under its rules.

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18 Cooper Statement. at ¶10. In real terms, rates went up 3.6%.

19 *Id.* at ¶11. In real terms, rates are increasing 5.6%.

20 *Id.* at ¶12.

In 1996, many cities experienced rate increases that exceeded 20%,[21] and overall, data collected by the BLS show that cable rates climbed at an annual pace of 10.4% in 1996 compared with 3.5% for all consumer goods.[22] According to local authorities, the cable rate increases in 1996 equaled the ones that led to passage of the 1992 Cable Act, and represented the largest increases since the record increases in 1990.[23]

An examination of individual cable companies reveals similar results. Tele-Communications, Inc. (TCI), the nation's largest cable company, boosted its rates about 13.5% in 1996.[24] In the Denver area, TCI raised its rates 19% in the summer of 1996, and then another 8% in June 1997.[25] In 1996, Time Warner, the number two cable operator in the U.S., increased its rates an average of 12% in the New York City area.[26] In the Washington, D.C., metropolitan area, cable rates increased in 1996 at almost triple the rate of inflation.[27]

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[21] Albert R. Karr, *Cable Rates are Up an Average 10.4% This Year*, Wall St. J., Aug. 28, 1996.

[22] *Id.* According to BLS data, the general CPI from January 1996 - January 1997 was 3.9%.

[23] *Id.*

[24] *Id.*

[25] Rebecca Cantwell, *TCI seeks $2 rate hike*, Rocky Mountain News, Mar. 4, 1997, at 1A.

[26] Mark Robichaux, *FCC's 'Social Contract' for Cable Companies Draws Ire*, Wall St. J., Jan. 29, 1996 at B4.

[27] Paul Farhi, *Cable TV Rates Going Up Sharply*, Washington Post, May 18, 1996, at A1.

This trend continues in 1997. Comcast recently announced that it would raise cable television rates 10.4% for most of its customers in Baltimore, Harford and Howard counties, Maryland.[28]

As these numbers reveal, existing cable television rate regulations are not achieving the chief goal of the 1992 Cable Act: to ensure reasonable cable rates. Therefore, the FCC must immediately undertake an investigation of existing cable rates to determine why they have been increasing so rapidly and how the regulations should be revised to bring rates down to a reasonable level.[29] While conducting this investigation, the Commission must freeze all current rates at existing levels to ensure that these rates not increase any further.[30]

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28 Larry Carson, *Cable rates to rise in area*, Baltimore Sun, September 11, 1997, at 1D.

29 Under any revised rate regulations, we anticipate that the Commission would follow a process comparable to the one followed under the current rules, with franchising authorities filing complaints on behalf of consumers. Given that the Commission's current regulatory formula permits monopolistic rate increases, there is no reason for a franchising authority to waste its resources and file complaints that would be rejected. However, with an appropriately calibrated formula, we anticipate that franchising authorities would file complaints to reduce cable rates.

30 The Commission certainly should not extend the 20-cent mark-up instituted in 1994 for each channel added to cable programming service tiers, which is set to expire on December 31, 1997. Sixth Order on Reconsideration, Fifth Report and Order, and Seventh Notice of Proposed Rulemaking, *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992*, FCC 94-286 (1994). The 20-cent mark-up, which was opposed by consumer groups, was established to provide an incentive to cable operators to add channels to their regulated tiers. At the same time, the FCC made the mark-up available for a limited period, which is set to expire at the end of 1997. An extension of the time period for the 20-cent mark-up beyond December 31, 1997, would result in on-going, unjustified windfalls to cable companies and even higher cable rates for consumers.

B. The Commission can rely on section 623(h) in freezing cable rates while it considers changes to its cable rate regulation formula.

In the *Cable Rate Freeze Order*, the Commission also relied on Section 623(h) of the 1992 Cable Act, 47 U.S.C. §543(h), in freezing rates for cable services for 120 days. Section 623(h) requires that the Commission establish regulations to prevent evasions of rate regulation. According to the legislative history, this provision was intended to give the FCC the authority to "address changes in the cable industry or the industry's business practices that would thwart the intent of this section."[31]

In 1993, the Commission froze rates for both basic cable service and cable programming services, reasoning that, if it froze only basic service tier rates, then cable operators could evade the freeze by moving programming from the basic tier to higher tiers. A cable operator would then be charging the basic service rate for only a few channels, thereby undermining the intent of section 623 -- to assure that basic service tier rates are reasonable.[32]

Similarly, section 623(h) authorizes the FCC to freeze current rates for basic and cable programming services while the Commission reevaluates its rate regulations. There is little doubt that many of the cable industry's business practices described in this petition are intended to evade the FCC's rate regulations in a manner that thwarts Congressional intent to keep rates reasonable and are responsible for steadily increasing cable rates. It is imperative that the Commission take decisive action to identify and respond to these business practices.

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[31] S. Rep. No. 92, *supra* note 5, at 77.

[32] *Cable Rate Freeze Order*, 8 FCC Rcd. at 2922, n. 10.

C. Section 4(i) of the Communications Act provides additional authority for a cable rate freeze and reevaluation of cable rate regulations.

Section 4(i) of the Communications Act, 47 U.S.C. §154(i), provides the Commission with the authority to perform any acts "as may be necessary in the execution of its functions." As the courts have explained, section 4(i) is "wide-ranging source of authority," a "necessary and proper clause" empowering the Commission to "deal with the unforeseen . . . to the extent necessary to regulate effectively those matters already within its boundaries."[33] The Commission relied on section 4(i) when it froze cable rates in 1993[34] and can likewise rely on this provision in initiating a reevaluation of its rate regulations and a rate freeze as requested in this petition. A reevaluation and rate freeze are "necessary" actions to be undertaken by the Commission in order for it to fulfill the statutory requirement that cable rates be reasonable.

II. GREATER CONCENTRATION IN THE CABLE TELEVISION MARKETPLACE JUSTIFIES COMMISSION REVIEW OF ITS RULES AIMED AT CURBING CONCENTRATION.

The 1992 Cable Act provided the FCC with the authority to establish limits on the ownership, control, and utilization of cable systems,[35] and to prohibit unfair practices.[36] However,

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33 *Mobile Communications Corp. of America v. FCC*, 77 F.3d 1399, 1494 (D.C. Cir. 1996); *North American Telecommunications Ass'n v. FCC*, 772 F.2d 1282, 1292 (7th Cir. 1985); *New England Tel. & Tel. Co. v. FCC*, 826 F.2d 1101, 1108 (D.C. Cir. 1987).

34 *Cable Rate Freeze Order*, 8 FCC Rcd at 2922, n. 10.

35 Section 613 of the Communications Act, 47 U.S.C.§533.

36 Section 628 of the Communications Act, 47 U.S.C. §548.

the resulting regulations -- where they have been implemented -- have been totally ineffective in curbing concentration in the cable television marketplace, and, therefore, must be reevaluated.[37]

The Commission's most recent annual report on competition in the video programming market[38] reveals an increasingly horizontally and vertically concentrated marketplace. The *Third Annual Report* found that concentration of cable systems at the national level increased between 1995 and 1996. During this period, the percentage of cable subscribers served by the four largest companies rose to 61.40%, with TCI (27.94%),[39] Time Warner (18.94%), Continental/US West (7.69%), and Comcast (6.83%) remaining the four largest.[40]

The *Third Annual Report* also found that, as a result of acquisitions and trades, cable system operators have continued to increase the extent to which their systems are forming regional clusters. The number of clusters serving at least 100,000 subscribers increased from 97

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37 We believe that section 4(i) of the Communications Act, discussed *supra* note 33 and 34 and accompanying text, provides the Commission with ample authority to reevaluate its rules relating to horizontal and vertical integration, and its rules governing unfair practices by cable companies.

38 *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, CS Docket No. 96-133. FCC No. 96-496 (Jan. 2, 1997)("*Third Annual Report*").

39 While on its own, TCI accounts for over one-quarter of the market, when one factors in all of its partially owned subsidiaries, its share of the market increases to more than one-third. Cooper Statement. at ¶39.

40 *Third Annual Report* at ¶130. The report also noted that the Herfindahl-Hirschman Index (HHI), a measure of concentration to the cable marketplace reveals a similar increase in concentration. These market shares indicate a nationwide cable industry HHI of 1098 in 1995, and 1326 in 1996.

to 137 between 1994 and 1995, and these clusters now account for service to approximately 50% of the nation's cable subscribers.[41] The clusters greatly expand regional cable monopolies.

Cable markets are not national in scope, they are local. Here the progress of concentration has been just as rapid. At the point-of-sale, which is the point of access to multi-channel video viewing, cable remains a firmly entrenched monopoly in the overwhelming majority of markets.[42]

While the financial arrangements between cable operators are getting more complex, the results are still quite simple: fewer and fewer entities are in control of the operations and programming of cable systems. Recent agreements entered into by the nation's largest cable company, TCI, provide a clear illustration of the problem. This spring, TCI had approximately 27% of all cable subscribers (about 18 million subscribers) when it entered into an agreement to sell some of its subscribers to Cablevision in exchange for 12 million newly issued shares of that cable company. As a result, TCI gained a minority of Cablevision stock (33%) and 2.8 million new subscribers.[43] As a result of this and other transactions, the large cable company has control

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[41] Third Annual Report at ¶137.

[42] Cooper Statement at ¶14 (citing *Third Annual Report* at ¶121, which also found an HHI of 7905 for the average local market, a figure that is several times greater than the 1800 threshold at which a market is considered "highly concentrated").

[43] Mark Robichaux, *Cablevision May Acquire TCI Customers*, Wall St. J., June 6, 1997, at B6. TCI then entered into a programming deal with Rupert Murdoch by which Cablevision's Rainbow Programming Holdings gave TCI an additional ownership interest in Cablevision (up to half of the 40% stake in Rainbow in addition to the 33% from the previous TCI-Cablevision deal). Mark Robichaux, *Fox-TCI Venture Nears Pact to Buy 40% Of Cablevision Sports for $850 Million*, Wall St. J., June 20, 1997, at B7.

over systems serving more than 21 million consumers (over one-third of all cable subscribers nationwide).[44]

On-going consolidation of ownership in the cable industry raises concerns about the likely development of a fully competitive market for video services. Last year's merger of Time Warner with Turner Broadcasting has created a competitively dangerous link between the largest entrepreneurs in the cable industry. This merger unites the owners of cable systems serving about one-half of all subscribers (with TCI gaining a 9% stake in Time Warner) and owning many of the most popular cable programming networks.

After Rupert Murdoch abandoned efforts to compete with cable, cable industry leaders helped Murdoch win the bidding to purchase the Family Channel, get carriage of his news channel on Time Warner's cable systems, and join the cartel of cable owners who run the Primestar satellite venture.[45] Now, in conjunction with TCI, Murdoch is expanding his sports programming empire by purchasing a large share of Cablevision Systems Rainbow Media Holdings, combining 18 regional cable sports channels, the Fox national TV network, Madison Square Garden, the New York Knicks, the New York Rangers and Los Angeles Dodgers in one ownership circle.[46]

To prevent undue concentration, Section 613(f)(2) of the Communications Act, 47 U.S.C. §533(f)(2), directs the Commission to establish rules that, among other things, will ensure that:

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[44] Mark Robichaux, *TCI is Closing Deals With Time Warner, Others to Shed Subscribers, Slash Debt*, Wall St.J., June 24, 1997, at B14. See also Cooper Statement at ¶39.

[45] Mark Robichaux and John Lippman, *Murdoch Sets Satellite-TV and Cable Deals,* Wall St.J., June 11, 1997.

[46] Paul Farhi and Leonard Shapiro, *A Sporting Chance to Be No. 1*," Washington Post, June 24, 1997. *See also* Cooper Statement at ¶15.

- no cable operator or group of cable operators can unfairly impede the flow of video programming;

- cable operators affiliated with video programmers do not favor such programmers; and

- the Commission take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests.[47]

Given the ongoing expansion of TCI and Time Warner in conjunction with market-consolidating satellite transactions, cable system swaps and programming deals, it is apparent that the Commission has failed to adequately implement this provision of the 1992 Cable Act. We urge the Commission to use the information included in this petition as the basis for a reevaluation of its rules aimed at curbing concentration in the cable television market.

A. FCC must lift its stay on the its horizontal ownership limits.

The 1992 Cable Act gave the Commission the authority to establish horizontal restrictions,[48] and the Commission adopted rules in 1993 that limited the number of cable subscribers a person is authorized to reach through cable systems owned by or attributable to,

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[47] 47 U.S.C. §533(f)(2)(A)-(C).

[48] *See* Section 613(f)(1)(A) of the Communications Act, 47 U.S.C. § 533(f)(1)(A).

such person.[49] These rules, however, have yet to be implemented.[50] As a result, there are no regulations controlling the growth of cable systems: the big cable companies are getting bigger and bigger, while their rates are getting higher and higher. The Commission must lift its self-imposed stay and implement new, effective horizontal subscriber limits.

B. FCC must revise its vertical ownership limits.

Among the findings of the 1992 Cable Act was that "[t]he cable industry has become highly concentrated. The potential effects of such concentration are barriers to entry for new programmers and a reduction in the number of media voices available to consumers."[51] With vertical integration, cable operators have the incentive and ability to favor their affiliated

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[49] *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits*, 8 FCC Rcd. 8565 (1993).

[50] The cable subscriber limits -- both the statutory provision and the implementing regulations -- were declared unconstitutional by the U.S. District Court for the District of Columbia in *Daniels Cablevision v. United States*, 835 F. Supp. 1 (D.D.C. 1993), *subsequent appeal sub nom.*, Time Warner Entertainment Co., L.P. v. FCC, 93 F.3d 957 (D.C. Cir. 1996), *reh'g en banc, denied,* Time Warner Entertainment Co, L.P. v. FCC, 105 F.3d 723 (D.C. Cir. 1997). In response to the *Daniels* decision, the Commission stayed its rules, pending an appellate decision regarding their constitutionality. The U.S. Court of Appeals for the District of Columbia Circuit, however, has postponed its consideration of the horizontal rules pending the FCC's reconsideration of them. The Commission has yet to issue an order on reconsideration, and is not scheduled to do so in the near future. The Center for Media Education and the Consumer Federation of America filed a motion in December 1993, asking the Commission to lift its stay of the horizontal ownership limits, but the motion has not been granted.

[51] Section 2(a)(4) of the 1992 Cable Act.

programmers, as well as program distributors using other technologies. This could make it difficult for noncable-affiliated programmers to secure carriage on cable systems.[52]

The 1992 Cable Act provided the Commission with the authority to enact rules that limit the number of channels on a cable system that can be occupied by a video programmer in which the cable operator has an attributable interest.[53] Such rules were adopted in 1993 but, as evidenced by recent developments in the cable marketplace, they have done nothing to prevent increasing market concentration.

The Commission's most recent annual report on competition in the video programming market reveals an increasingly concentrated marketplace. According to the report, cable multi-system operators, either individually or collectively, own a majority of interest in 47 national cable programming networks, compared with 45 networks.[54] Eight of the thirteen most popular cable networks are substantially owned by cable operators[55], and a substantial portion of overall cable programming is owned by the largest companies.[56]

Cable companies are able to pass programming costs through to consumers and competitors under the FCC's relaxed regulations and thereby make programming their profit center. While the price of basic and expanded basic cable programming shot up 19% in 1995, the

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52 Section 2(a)(5) of the 1992 Cable Act.

53 Section 613(f)(1)(B) of the Communications Act, 47 U.S.C. Sec. 533(f)(1)(B).

54 *Third Annual Report* at ¶¶130-145 (footnotes omitted).

55 Testimony of Gene Kimmelman, Co-Director, Washington Office of Consumers Union, on Multichannel Video Competition, before the Committee on Commerce, Science, and Transportation, United States Senate, April 10, 1997, Table 1.

56 *Id. at* Table 2.

price of competitive premium cable channels and non-cable-owned broadcast channels rose only 2%.[57] Obviously, the price of cable-owned programming, not subject to competition, has been artificially inflated to circumvent the goals of regulation.

In light of the current situation in the cable television marketplace, we urge the FCC to reevaluate its channel occupancy rules, including the channel occupancy limit and the vertical ownership attribution standard.

C. The Commission should reevaluate its rules aimed at prohibiting unfair methods of competition or unfair or deceptive acts and practices.

The 1992 Cable Act provided the Commission with the authority to prohibit cable operators from engaging in unfair methods of competition, or unfair and deceptive acts and practices.[58] The rules adopted by the FCC to implement section 628 47 C.F.R. §§76.001, 76.1002, appear to be inadequate. The type of anti-competitive behaviors exhibited by cable operators include exclusive deals with independent programmers that freeze out overbuilders,[59]

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57 *Third Annual Report* at ¶19.

58 Section 628 of the Communications Act, 47 U.S.C. §548.

59 Cooper Statement at ¶51, n.51 (BellSouth and Ameritech both cite to examples of suspected exclusive arrangements involving Eye on People, MSNBC, Viacom, and Fox).

refusals to deal for programming based on potential loopholes in the law requiring non-discriminatory access to programming,[60] tying arrangements,[61] and denial of access to facilities.[62]

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[60] Cooper Statement at n. 52 (one example of a potential loophole, alleged by both BellSouth and Ameritech, is the terrestrial transmission to regional clusters, thereby avoiding the requirement to provide non-discrijminatory access to satellite delivered programming).

[61] *Id.* at n. 53 (BellSouth contends that tying agreements exist between NBC/CBS, and Scripps Howard/Home and Garden).

[62] *Id.* at n. 54

CONCLUSION

The Commission should act immediately to restrain abuses in the cable television market, invoking its power to regulate prices to reverse the recent dramatic price increases imposed on the public. Simultaneously, it should exercise its continuing regulatory authority to attack the underlying problem of market power and economic concentration in the industry.[63] Congress' goals of promoting competition and reasonable prices in passing the 1992 Cable Act and the 1996 Telecommunications Act cannot be attained unless the Commission cracks down on transactions and agreements like those discussed above and freezes skyrocketing cable rates.

Respectfully submitted,

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September 23, 1997

[63] Cooper Statement at ¶3.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In Re: Petition of Consumers Union and the	)	
Consumer Federation of America to Update	)	MM Docket Nos. 92-264, 92,265, 92-266
Cable TV Regulation and Freeze Existing	)	
Cable Television Rates	)	

STATEMENT OF DR. MARK N. COOPER

SEPTEMBER 22, 1997

CONTENTS

I. PURPOSE AND OVERVIEW OF FINDINGS

A. QUALIFICATIONS AND PURPOSE

1. My name is Dr. Mark N. Cooper. I am Research Director for the Consumer Federation of America. I have been asked by Consumer's Union to prepare an analysis of the current state of competition and pricing behavior in the cable television industry.

2. My analysis of the structure, conduct and performance of the cable industry leads me to conclude that, at best, market forces are weak in the industry and becoming weaker.[1] As a result, consumers are being abused by the exploitation of market power. This problem has become critical in the period since the passage of the Telecommunications Act of 1996 (the 1996 Act).[2]

3. Therefore, the Commission should act immediately to restrain these abuses, utilizing its power to regulate prices to reverse the recent dramatic price increases imposed on the public. Simultaneously, it should exercise its continuing regulatory authority to attack the underlying problem of market power and economic concentration in the industry.

4. The remainder of my analysis is organized as follows. In Section II I briefly review the key indications of the severe deterioration of market forces since the passage of the 1996 Act. In Section III I review the longer term trends in the industry structure, demonstrating that the developments which took place in the year and a half since the passage of the 1996 Act are not an aberration, rather they are an ominous indication of the historic tendency of the industry toward concentration and abuse of market power. This is a tendency that can and should be resisted by the FCC. In Section IV I review the recent pricing patterns and other indications of market performance in long term historical perspective.

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[1] Extensive analyses of various aspects of industry structure up to the passage of the Telecommunications Act of 1996 can be found in Mark Cooper, The Economics of Deregulation and Reregulation in the Cable Industry: A Consumer View (Consumer Federation of America, September 1992) (hereafter, Cable Economics); "Comments of the Consumer Federation of America," In the Matter of Implementation of the Cable Television Consumer Protection Act of 1992, Federal Communications Commission, January 23, 1993; Marl Cooper, Economic Concentration and Diversity in Broadcast Media (Consumer Federation of America, November 1995) (hereafter Media Concentration).

[2] Pub. L. 104-104, 110 Stat. 56 (1996).

B. THE RAPID DETERIORATION OF MARKET FORCES IN THE CABLE INDUSTRY

5. In order to describe the economic dynamics of the industry and the pattern of behavior that has developed under policies of deregulation and reregulation I adopt the Structure Conduct Performance (SCP) approach to industry analysis. The SCP approach has been the dominant public policy paradigm in the United States for the better part of this century.[3]

1. PRICING PATTERNS

6. From the consumer point of view, the most visible and immediate indication of the deteriorating conditions in the industry is the price which consumers are forced to pay for services.

7. Figure 1 shows the trend in cable prices since full deregulation in 1986. This shows the clear impact of price policy and the tendency of the unregulated industry to engage in abusive pricing.

8. Between early 1986, when full deregulation of prices under the Cable Communications Policy Act of 1984 (the 1984 Act)[4] took effect, and early 1993, when price regulation went into effect following the Cable Television Consumer Protection and Competition Act of 1992 (the 1992 Act),[5] prices increased at an annual average rate of just over 8.3 percent per year. As Table 1 shows, in real terms prices were increasing by about 4.3 percent per year.

9. In the two years (1993-1995) when the FCC began cracking down on abusive pricing, rates declined by about 2.8 percent per year. Prices were declining in real terms by about 5.2 percent.

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3 F.M. Sherer, Industrial Market Structure and Economic Performance (New York: Rand McNally, 1990), Chapter 1.

4 47 U.S.C., S. 543.

5 Pub. L. No. 102-385, 106 Stat. 1460 (1992).

10. However, under pressure from the cable industry and its supporters in Congress to eliminate regulation,[6] the Commission adopted the "Going Forward Rules" and prices again increased rapidly. Since the adoption of the going forward rules, prices have increased by 6.3 percent. In real terms they are up 3.6 percent.

11. There are two distinct periods of price changes since the adoption of the Going Forward Rules, however. In the year and a half after the Going Forward Rules were adopted up until the passage of the 1996 Act, prices increased by about 4.5 percent per year, or about 1.3 percent in real terms. The passage of the 1996 Act seems to have opened the door to much larger price increases. Since the Act, prices have been increasing by about 8.2 percent per year, or about 5.6 percent per year in real terms.

12. Prices are now higher than the Federal Communications Commission expected when it published the Going Forward Rules (see Figure 2). They are four percent higher than was expected. Since the passage of the 1996 Act, prices have increased almost 1.5 times as fast (50 percent faster) as the FCC predicted when it adopted the Going Forward Rules.

2. STRUCTURAL CONDITIONS

13. Economic theory teaches that pricing patterns reflect the underlying market structures and the conduct of market actors. Therefore, it is not surprising to find that for the first time in the history of the industry, even at the national level, it has passed the moderately concentrated threshold as measured by a Hirshman Herfindahl Index (HHI) of 1000.[7] This is true even by the FCC's most lenient approach to measuring

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[6] See Report of the House Commerce Committee on H.R. 1555 the Communications Act of 1995, pp. 7-8; see also Report of the Senate Committee on Commerce, Science and Transportation on S. 652, The Telecommunications Competition and Deregulation Act of 1995, p. 13, describing Senator Pressler's "Republican Draft" legislation and ensuing events.

[7] Identification of exactly where a small number of firms can exercise this power is not a precise science. Generally, however, when the number of significant firms falls into the single digits, there is cause for concern, as the following suggests (J.W. Friedman, Oligolopy Theory (Cambridge University Press, 1983), pp. 8-9).

> Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.

concentration.[8] Using a traditional measure of concentration at the national level, the

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The clear danger of a market with a structure equivalent to only six equal sized firms was recognized by the Department of Justice in its Merger Guidelines (revised 1984). These guidelines were defined in terms of the Herfindahl-Hirschman Index (HHI). This measure takes the market share of each firm squares it, sums the result and multiplies by 10,000. A market with six equal sized firms would have a HHI of 1667. The Department declared any market with an HHI above 1800 to be highly concentrated. Thus, the key threshold is at about the equivalent of six of fewer firms.

Another way that economists look at a market at this level of concentration is to consider the market share of the largest four firms (4-Firm concentration ratio). In a market with six equal sized firms, the 4-Firm concentration would be 67 percent. The reason that this is considered an oligopoly is that with that small a number of firms controlling that large a market share, their ability to avoid competing with each other is clear.

Shepherd describes this threshold as follows (W.G. Shepherd, The Economics of Industrial Organization (Englewood Cliffs: Prentice Hall, 1985), p. 4):

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

However, as the above quote indicates, one must have many more firms than six to be confident that competition will prevail -- perhaps as many as fifty. Reflecting this basic observation, the Department of Justice established a second threshold to identify a moderately concentrated market. This market was defined by an HHI of 1000, which is equivalent to a market made up of 10 equal sized firms. In this market, the 4-Firm concentration ratio would be 40 percent.

Shepherd describes this threshold as follows:

> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

Bates summarizes Shepherd's discussion in terms of HHI indexes as follows:

> Following guidelines proposed by Shepherd, one could roughly identify markets with HHI > 1500 as tight oligopolies, and those with HHI <1000 as loose oligopolies.

Even the moderately concentrated threshold of the Merger Guidelines barely begins to move down the danger zone of concentration from 6 to 50 equal sized firms. For a "commodity" with the importance of cable TV, certainly this moderately concentrated standard is a more appropriate place to focus in assessing the structure of the market. In other words, in simple economic markets levels of concentration typified by 10 equal sized firms are high enough to raise questions about the competitive behaviors of the firms in the market. Given the nature of the media and the special concern about the free flow of ideas, this is a conservative level of concentration about which to be concerned.

[8] The FCC has put forward a series of market definitions and a variety of measures of industry structure (Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 96-133, January 2, 1997, pp. 61-64 (hereafter Third Annual Report). The FCC acknowledges that the market